

DISPUTE AVOIDANCE AND DISPUTE RESOLUTION IN CHINA

by The China Team

While conducting business in China, foreign companies occasionally find themselves embroiled in disputes with Chinese individuals, companies, or the Chinese Government. The number of cases involving the first two categories far exceeds those of the third. The best approach in dealing with individual disputes varies from case to case. Nevertheless, Department of Commerce officials with extensive experience in such disputes have prepared the following guidelines to assist U.S. companies doing business in China.

DISPUTES WITH CHINESE COMPANIES OR INDIVIDUALS

There are three primary ways to resolve a commercial dispute in China: negotiation, arbitration and litigation. Simple negotiation with your partner is usually the best method of dispute resolution. It is the least expensive and it can preserve the working relationship of the parties involved. In fact, most business contracts in China include a clause stipulating that negotiation should be employed before other dispute settlement mechanisms are pursued. When a foreign firm experiences difficulty in directly negotiating a solution to a dispute with its Chinese partner, companies sometimes seek assistance from Chinese government officials who can encourage the Chinese party to honor the terms of the contract. Companies should specify a time limit for this process. Unfortunately, negotiations do not always lead to resolution.

Arbitration is the next preferred method. Unless the parties can agree on arbitration after the dispute has arisen (which is often difficult), the underlying contract or separate agreement must indicate that disputes will be resolved through arbitration. Agreements to arbitrate usually specify a choice of arbitration body, which may be located in China or abroad, and a choice of law to govern the dispute. There are two Chinese government-sponsored arbitration bodies for handling cases involving at least one foreign party: China International Economic and Trade Arbitration Commission (CIETAC) and, for maritime disputes, China Maritime Arbitration Commission (CMAC). Contracts involving foreign companies doing business in China often provide for CIETAC arbitration. CIETAC distinguishes between two kinds of dispute resolution, foreign-related and domestic. For a dispute to be classified as foreign-related, one of the companies must be a foreign entity without a major production facility or investment in China.

For foreign-related disputes where CIETAC is the selected arbitration body, parties to the contract may specify the nationality of members of the arbitration panel in the contract; CIETAC has implemented contract clauses that stipulate that two of the three arbitrators, including the presiding arbitrator, must be non-Chinese. CIETAC does not have to pre-approve any contractual stipulations on the nationality of the negotiators. CIETAC has published rules which govern the selection of a panel if the contract does

not specify how the choice of arbitrators will be handled. CIETAC's list of arbitrators for foreign-related disputes, from which CIETAC's arbitrators must be chosen, includes many non-Chinese arbitrators. Although many foreign experts believe that some aspects of CIETAC need to be improved, it has developed a good reputation.

Companies should be aware when drafting a contract that, as an alternative to CIETAC or CMAC, they can specify an arbitration body outside China, such as Singapore, Stockholm or Geneva. In addition, Hong Kong—under one country, two systems—has a separate and well-regarded international commercial arbitration system. In 1987, China acceded to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention). Under the New York Convention, arbitral awards rendered in other signatory countries are recognized and enforceable in China. By the same token, arbitral awards by Chinese arbitration bodies are enforceable in other countries signatory to the New York Convention.

A final way to resolve a commercial dispute in China is through litigation in Chinese courts. In China, foreign individuals and companies have the same ability to bring action in court as Chinese citizens and companies. There are three levels of courts in China. Every major city has basic courts and intermediate courts. Supervising these courts are the provincial high courts. The Supreme People's Court, located in Beijing, has appellate jurisdiction over

Good planning can help you avoid disputes. Department of Commercial officials with extensive experience with commercial disputes, recommend U.S. companies consider the following:

1. Have clear contract terms. Specify exact terms of payment and performance standards. Set time lines. Include specific dispute resolution clauses, including details on the procedure and maintenance of operations during a pending dispute. Pay careful attention to details, such as initialing pages of contracts and signing properly. Make sure the Chinese version of the contract is consistent with the English version. Do not attempt to enter into an agreement without sound legal advice.
2. Make certain your project is economically viable by its own terms. Profitability of a project or the sale of goods and services should be based on sound economic criteria. Do not rely on promises of subsidies, special considerations, or nonmarket related sources of income to generate a profit.
3. Make sure you know your partner. Do your "due diligence," and do it well. Choose your partner carefully and only after a careful examination of experience and dependability. Check the reliability of the data your partner or customer provides from independent sources. Avoid being "stovepiped" – talking only to those people to whom your partner or buyer directs you.
4. Make sure you get paid. A contract with an insolvent partner or customer is worthless. Pay careful attention to how you get paid, when you get paid, and in which currency. If you have agreed to be paid in Chinese Yuan, verify that you can convert profits to U.S. dollars. Use letters of credit or other financial instruments to protect yourself.
5. Do not enter into prohibited agreements. American companies have often entered into agreements with promises from local officials that central government rules will not be enforced in the provinces. While this is sometimes true, problems may arise when these rules are suddenly applied—sometimes retroactively—leaving the company with little recourse. In particular, you must be prepared to obey the central government's implementation of revised laws, regulations and practices in its efforts to meet its WTO obligations, regardless of promises to the contrary by local officials.
6. Be careful not to base your business on WTO-noncompliant rules. The U.S. Government cannot support you if you are relying on a business plan that is dependent on Chinese regulations that violate the WTO. As such rules are replaced, you may find your competitive advantages eroded.
7. Search for problems before they materialize. In addition to creating pro forma balance sheets, spend some time at the beginning of a project to examine what you will do if things go wrong. Try to anticipate possible problem areas. If you can't find any, you are not looking hard enough. Create a strategy to deal with potential problems. You know how much profit you want to make. Know your company's limits on losses as well.
8. Do a thorough risk analysis. Be realistic about how much risk you are willing to accept in your business venture. Make sure you use reliable sources for this assessment. Use more than news media sources or your immediate partners to evaluate the risk.
9. Limit your exposure. Set milestones in the project for performance. Have an escape strategy for each stage of the project, even though you don't plan to use it.
10. Mind the store. Projects and sales in China require constant attention. Do not assume they will run themselves.

all courts in China. Cases involving foreign interests can be filed in either the basic-level courts or intermediate courts, depending on their nature. Most observers agree that Chinese courts are not up to international standards. For instance, most judges have minimal or no legal training and observers have stated those poorly trained court officials are susceptible to corruption and regional protectionism.

In both the arbitration and litigation contexts, mediation represents an early step in the resolution of the dispute. In arbitration before CIETAC or in litigation before the Chinese courts, parties are encouraged to participate in mediation with mediators selected by the arbitral panel or during an in-court session, respectively. The principle of mediation is that the parties may present their proposals to the mediator who suggests a solution based on those proposals. Mediation is by definition non-binding and has achieved great success as a means of settling international commercial disputes between foreign and Chinese parties.

In China, arbitration offers many advantages over litigation. A major advantage is the finality of the rulings. Court rulings are subject to appeal, which means litigation may continue for years. As indicated above, judges in China are often poorly qualified, while arbitration panels are made up of a panel of experts, which improves the quality of the hearing. In addition, the proceedings and rules of arbitration are often more transparent than litigation.

Many observers have noted that it is often difficult for parties to enforce and obtain payment on court judgments and arbitral awards in China. While courts are required to receive approval from the Supreme People's Court prior to refusing to enforce a foreign arbitral award, courts have occasionally circumvented this requirement by employing delaying tactics when local interests are adversely affected by the arbitration rulings. The Supreme People's Court has issued new guidelines

to limit the ability of local courts to delay enforcement and this appears to have had a positive effect.

THE ROLE OF THE U.S. GOVERNMENT IN COMMERCIAL DISPUTES

American companies involved in a dispute often approach the Department of Commerce and other U.S. agencies in China or the United States for assistance. The Department can provide companies with assistance in navigating China's legal system, provide a list of local attorneys, and share basic information on potentially applicable trade agreements and relevant Chinese business practices. The Department is not able to provide American companies or individuals with legal advice.

American companies that have disputes with private firms often request U.S. Government intervention with Chinese authorities on their behalf. Such intervention is rarely appropriate unless the company has exhausted all remedies under China's legal system. The Department's efforts in assisting with commercial disputes are aimed at achieving a fair and timely resolution in accordance with Chinese law and advancing both countries' interest in adequate legal and judicial protection for all parties.

When a dispute is in the Chinese court system, Embassy officers will intervene on behalf of an American company only in extremely limited circumstances and in accordance with U.S. government guidelines.

DISPUTES INVOLVING THE CHINESE GOVERNMENT

When a U.S. firm has a dispute with the Chinese Government, a Chinese state-owned enterprise, or a government-subsidized project, the most effective initial step is to quietly raise the issue with the entities involved, citing the importance of foreign companies' investment in China. The firm should explain its situation to the

Chinese entity, and offer to work with it to resolve the problem amicably. This allows for a more aggressive approach at a later date, if necessary. The Department can work with companies in considering the best strategy.

While China is obligated to fully implement the terms of its trade agreements, including the WTO once it is a member, differences over implementation may arise. In such circumstances, the Department is committed to working with firms and the Chinese Government to ensure full compliance. Generally, U.S. Embassy staff and Washington agencies will work directly with concerned companies, or the industry association, to identify solutions and formulate strategies. If appropriate, the Embassy will advocate on behalf of the American companies with Chinese officials. If the dispute cannot be resolved at this level, and additional U.S. Government support is appropriate, the U.S. involvement will usually involve increasingly senior level officials of the appropriate U.S. Government agencies. If compliance with WTO obligations underlies the dispute, the U.S. Government will examine the possible use of WTO dispute settlement procedures. In reaching a dispute resolution strategy, a firm should consider all possibilities, including negotiation, arbitration, mediation or litigation, and the time and expense that it may take to resolve the problem. ■

FOR MORE INFORMATION REGARDING DISPUTE RESOLUTION IN CHINA, CONTACT:

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